Powell’s Latest Mid-Cycle Adjustment

See the collection of the individual charts linked below.


The Fed I: Powell’s Crib Notes. On Thursday, the FOMC lowered the federal funds rate by 25bps to 1.75%-2.00% (Fig. 1). The cut was widely expected. Melissa and I think the FOMC can take the rest of the year off.

We noticed that during his press conference after the committee’s meeting, Fed Chair Jerome Powell responded to several of the questions from the assembled reporters by reading from prepared statements. He has learned that he can get into trouble by speaking off-the-cuff. So he came prepared with scripted answers to the questions he anticipated would be asked at the presser. He did his best to say nothing that would upset the markets. He succeeded.

On Thursday, the S&P 500 rose just 0.06% while the 10-year US Treasury bond yield remained around 1.80% (Fig. 2 and Fig. 3). On Friday, the former fell 0.50% while the latter edged down to 1.74%. Friday’s moves occurred late in the day and mostly reflected disappointing news about the latest meeting of US and Chinese trade negotiators.

The bond yield is up 25bps from its recent low of 1.47% on 9/4 on better-than-expected US economic numbers and chatter about fiscal stimulus in Germany. Nevertheless, the financial markets are still expecting more rate cuts according to the 12-month federal funds rate futures, which was 1.39%, and the 2-year Treasury yield, which was 1.69%, on Friday (Fig. 4).

While Powell didn’t say anything that riled the financial markets, he did have a lot to say about numerous issues that are important for monetary policy and therefore for investors to consider:

(1) Data dependent and uncertain. Melissa and I believe that Powell should keep his press conferences short. In his preliminary prepared remarks, he should review what the FOMC had decided to do at the latest meeting of the committee and why. Then, he should say: “As always, the future course of monetary policy will remain data dependent.” During the Q&A, he should respond by repeating this mantra when asked about the future course of monetary policy.

In his latest presser, Powell seemed to be taking our advice. The word “data” was mentioned 17 times in the context of messaging that the Fed is data dependent, 11 times by him and 6 by reporters. During his prior presser, in July, Powell used the word in that context 5 times, fewer than reporters’ 6 times. So in the latest presser, Powell accounted for the majority of the mentions, or 65% of them, up from 45% at
July’s presser.

His emphasis on the Fed’s data dependence reflects the Fed’s greater uncertainty about the future. The words “uncertain” or “uncertainty” appeared 21 times, with 13 times by Powell in last week’s presser, up from 9 times in July, when all mentions were Powell’s. In both pressers, he mentioned the words 4 times during his prepared preliminary remarks.

So the Fed is uncertain about the future course of the economy—all the more reason to be data dependent. That was the gist of his latest press conference. No wonder the financial markets didn’t move in response to Powell’s post-meeting comments.

(2) The yield curve. Powell briefly spoke about the inversion of the yield curve and also about the long end of the curve, i.e., the bond yield. It was music to our ears, because his views happen to coincide with ours on both subjects. He opined, as we have, that an inverted yield curve may not be as good a predictor of recessions as in the past because the long bond yield has been pulled down by negative bond yields in Europe and Japan, which have been brought down by the negative interest-rate policies (NIRPs) of the ECB and BOJ.

Meanwhile, the yield curve based on the spread between the 10-year and 2-year Treasury bond yields (the 10-2 yield curve) hasn’t really inverted; it remains flat. The recent backup in the bond yield along with the Fed’s latest rate cut reversed the recent inversion of the yield curve based on the spread between the 10-year Treasury yield and the federal funds rate (Fig. 5).

Powell said that the “yield curve is something that we follow carefully.” He observed that “there’s this large quantity of negative yielding and very low yielding sovereign debt around the world, and inevitably, that’s exerting downward pressure on U.S. sovereign rates without really necessarily having an independent signal.” That neatly describes our “Modern Tether Theory” of the bond market. As we have observed since last year, US bond yields have been tethered to German and Japanese bond yields (Fig. 6).

By the way, in our 4/7 study “The Yield Curve: What Is It Really Predicting?,” we argued that the Fed should pay more attention to the curve—raising interest rates when it is ascending, pausing when it is flat, and cutting rates when it is inverted. In other words, the 10-2 yield curve supported the Fed’s decision to pause rate-hiking earlier this year but did not support the easing decisions made at the last two meetings.

In our study, we also observed that the yield curve has a very good track record of calling recessions because it has often accurately anticipated the credit crunches that have caused recessions. There are no signs of that now. Indeed, during August, a mere net 1% of small business owners reported that their last loan was harder to get than the previous one (Fig. 7).

(3) Negative interest rates. At his press conference last week, Powell declared that NIRP won’t happen on his watch. During the Q&A, he said: “I do not think we’d be looking at using negative rates, I just don’t think those will be at the top of our list.” Does that mean it was still on the list, but at the bottom?

Powell added: “If we were to find ourselves at some future date again at the effective lower bound, again not something we are expecting, then I think we would look at using large scale asset purchases and forward guidance.” He stated that “[w]e feel that they worked fairly well” and concluded that “[w]e did not use negative rates.” In other words, Powell isn’t ready to satisfy Trump’s NIRP envy.

(4) Trade uncertainty. The word “trade” was mentioned 31 times in the latest presser versus 30 times at
the July presser, which also followed a 25bps rate cut. Powell mentioned the word 7 times in his preliminary prepared remarks, up from 6 times in July. In both pressers, trade was referred to as a cause of the economic uncertainty that is depressing business spending and justified this year’s two rate cuts so far.

Recall that our 7/11 Morning Briefing was titled “Powell Gets Trumped!” We wrote: “President Donald Trump wants the Fed to lower interest rates. Fed Chair Jerome Powell claims that the Fed is independent and won’t bow to political pressure. Yet Trump has figured out the perfect way to force the Fed to lower interest rates. All he has to do is keep creating uncertainty about US trade policy.”

(5) Done? So what’s next? At his previous presser, Powell characterized July’s 25bps rate cut as a “mid-cycle adjustment.” When asked whether the latest cut was more of the same, he seemed to agree that it was, noting that similar adjustments during 1995 and 1998 kept the economy growing.

Late last year, we called for the Fed to stop hiking for a while. So we were all for the Fed’s pause at the start of this year. We haven’t been as gung-ho about the past two rate cuts. We like even less the thought of another cut sometime given the recent surge in retail sales and rebound in industrial production, which led to an upward revision in the 9/18 GDPNow forecast for Q3 to 1.9%. The Citigroup Economic Surprise Index has rebounded since mid-year, much as it did during 2017, which was a good year for the economy (Fig. 8). The data that the Fed depends on doesn’t justify another rate cut.

By the way, did you notice? Powell didn’t dwell on inflation in his latest presser. He didn’t say that the recent dip in the core PCED inflation rate might be “transient,” as he did during his May presser; in fact, he hasn’t mentioned that word since then. To be fair, Powell didn’t entirely ignore the topic of inflation in the recent press conference; he said that the FOMC expects inflation to rise back to 2.0% (yada, yada, yada). But he made no mention of the higher-than-expected core CPI inflation data, which we thoroughly discussed last week.

The Fed II: Concerns About Business Spending. Many businesses’ spending plans have been put on hold lately as a result of Trump’s trade policies, as Powell observed during his latest presser: “Our business contacts around the country have been telling us that uncertainty about trade policy has discouraged them from investing in their businesses. Business fixed investment posted a modest decline in the second quarter and recent indicators point to continued softness.”

Indeed, in the Fed’s September Beige Book, which qualitatively surveys business sentiment, the word “uncertainty” was used 29 times (up from 21 in the previous Beige Book), most often related to tariffs and trade tensions. Powell’s statement was also supported by a 9/4 FEDS Notes titled “Does Trade Policy Uncertainty Affect Global Economic Activity?” Here’s the conclusion:

“We find that the rise in TPU [trade policy uncertainty] in the first half of 2018 accounts for a decline in the level of global GDP of about 0.8 percent by the first half of 2019. Had trade tensions not escalated again in May and June 2019, the drag on GDP would have subsequently started to ease. However, renewed uncertainty since May of 2019 points to additional knock-on effects that may push down GDP further in the second half of 2019 and in 2020.”

Let’s review the latest batch of mixed capital-spending indicators:

(1) CEO survey. The Business Roundtable CEO Economic Outlook Index decreased during Q3 to 79.2, down from a record high of 118.6 during Q1-2018 and the lowest reading since Q4-2016 (Fig. 9). The CEO sentiment index is highly correlated with the growth rate of capital spending in real GDP, which was down to 2.7% y/y from a recent high of 6.9% during Q2-2018. CEOs’ plans for capital investment
decreased 14.7 points to 73.4, which is lower than the capital investment sub-index’s historical average of 76.7.

The latest quarterly survey (conducted from 8/23-9/9) asked 138 CEOs about their forward-looking expectations for sales, hiring, and capital investment. According to the report: “This quarter, CEO plans waned likely due in part to growing geopolitical uncertainty, including U.S. trade policy and foreign retaliation, and slowing global economic growth.”

(2) Small business survey. August’s NFIB survey of small business owners found that their capital-spending plans remain surprisingly firm: “Twenty-eight percent plan capital outlays in the next few months, up 1 point. Plans to invest were strong in manufacturing, 35 percent and agriculture and the wholesale trades each at 30 percent. The effects of the new tariff wars remain uncertain. Owners are more reluctant to make major spending commitments when the future becomes less certain so the increase is not supportive of future capital investment.”

(3) Industrial production. The Fed study cited above notes that a rise in trade-policy uncertainty in 2018 and 2019 has coincided with a slowdown in world industrial production and global trade. Domestically, industrial production of business equipment has stalled over that timeframe (Fig. 10). Of the three components in the series, transit equipment has lost the most ground, falling 2.1% y/y through August. That makes sense, since it is the component most sensitive to trade. Industrial equipment is down too, by 0.4%, while IT equipment is up 5.0%.

(4) Durable goods orders. Nondefense capital goods shipments excluding aircraft has stalled for the past two years around the current expansion’s cyclical peak, so far (Fig. 11). However, orders for these goods remains on an uptrend and in record-high territory so far this year. Then again, a broad range of machinery orders has been flat to down since mid-2018 (Fig. 12).

The Fed III: The Dot Plot Thickens. The “dot plot” of the latest FOMC meeting participants’ economic outlook shows median expectations for the federal funds rate at 1.90% in 2020, unchanged from this year. (See our FOMC Summary of Economic Projections.) At their meeting a year ago, they were projecting 3.4% for next year and 3.1% for this year. Their estimate for the longer-run federal funds rate (deemed to be the unmeasurable “neutral interest rate”) has dropped from 3.0% to 2.5% over this period.

The range of rate forecasts for this year is 1.6%-2.4%, with five expecting no change over the rest of this year, seven participants expecting the FOMC to lower the federal funds rate further, and five participants expecting the Fed to be hiking over the rest of this year. Indeed, at the latest meeting, there were three dissenteres, with two preferring no change and one calling for a half-point cut in the federal funds rate.

CALENDARS

US. Mon: M-PMI & NM-PMI Flash Estimates 50.3/51.4, Chicago Fed National Activity Index 0.13, Williams, Daly, Bullard. Tues: Consumer Confidence 133.0, S&P Case-Shiller Home Price Index 2.2% y/y, Richmond Fed Manufacturing Index 1. (DailyFX estimates)

Global. Mon: Eurozone, Germany, and France C-PMI Flash Estimates 52.0/51.5/52.6, Eurozone, Germany, and France M-PMI Flash Estimates 47.3/44.0/51.2, Eurozone, Germany, and France NM-PMI Flash Estimates 53.2/54.3/53.2, Japan C-PMI, M-PMI, and NM-PMI Flash Estimates, Draghi, Tenreyro. Tues: Germany Ifo Business Climate, Current Assessment, and Expectations Indexes 94.5/97.0/92.0, BOJ Minutes of July Meeting, Lowe, Guindos, Kuroda. (DailyFX estimates)
**STRATEGY INDICATORS**

**Global Stock Markets Performance** ([link](#)): Last week saw the US MSCI index fall 0.5% to 1.3% below its 7/27 record high. The AC World ex-US dropped 0.3% for the week but remains in a correction at 13.8% below its record high, in January 2018. The US MSCI’s weekly performance ranked 24th among the 49 global stock markets we follow in a strong week for global markets in which 17 of the 49 countries rose in US dollar terms. That compares to the prior week’s 36/49 ranking, when the US MSCI rose 0.9% as 41 markets rose. These regions outperformed the AC World ex-US: EMEA (0.4%) and EM Eastern Europe (0.1). The regions underperforming the AC World ex-US last week: BRIC (-1.2), EM Latin America (-0.6), EM Asia (-0.4), and EAFE (-0.4). Argentina was the best-performing country, with a gain of 6.1%, followed by Pakistan (2.9), Greece (2.8), Portugal (2.5), and Korea (2.5). Of the 27 countries that underperformed the AC World ex-US MSCI last week, Turkey and Hong Kong fared the worst with drops of 4.4%. Also underperforming were South Africa (-4.3), Ireland (-3.5), and Poland (-3.4). The US MSCI’s ytd ranking dropped one place last week to 8/49, with its 19.5% ytd gain nearly double that of the AC World ex-US (10.4). All regions and 37/49 countries are in positive territory ytd. The regions that are outperforming the AC World ex-US ytd: EM Eastern Europe (15.5), EMU (12.5), and EAFE (11.2). EM Latin America (4.8) is the biggest laggard ytd, followed by EM Asia (6.1), EMEA (7.0), and BRIC (8.8). The best country performers ytd: Egypt (36.6), Russia (27.2), Greece (26.5), Belgium (21.3), and the Netherlands (21.0). The worst-performing countries so far in 2019: Argentina (-34.0), Pakistan (-14.9), Poland (-11.0), Chile (-9.1), and Sri Lanka (-6.8).

**S&P 1500/500/400/600 Performance** ([link](#)): All three of these indexes fell together for the first time in four weeks. LargeCap’s 0.5% decline was less than the decreases recorded by MidCap (-0.9%) and SmallCap (-1.4). LargeCap ended the week 1.1% below its 7/26 record high of 3025.86, and MidCap fell to 5.2% below its record high on 8/29/2018. SmallCap remained in a correction for an 11th month as it dropped to 12.4% below its 8/29/2018 record. Nine of the 33 sectors moved higher last week, compared to 29 rising a week earlier. Last week’s best performers: LargeCap Utilities (2.2), LargeCap Real Estate (2.1), MidCap Real Estate (1.4), LargeCap Health Care (1.0), and LargeCap Energy (1.0). SmallCap Communication Services (-4.6) was biggest underperformer, followed by SmallCap Materials (-4.1), MidCap Communication Services (-3.2), MidCap Consumer Staples (-2.9), and SmallCap Consumer Discretionary (-2.9). In terms of 2019’s ytd performance, all three indexes have logged double-digit gains. LargeCap leads with a gain of 19.4% ytd, 2.5ppts ahead of MidCap (16.9) and well ahead of SmallCap (13.9). Thirty-one of the 33 sectors are positive ytd, with the cyclicals leading the top performers: LargeCap Tech (29.6), MidCap Tech (28.3), SmallCap Tech (27.4), LargeCap Real Estate (26.2), and LargeCap Communication Services (23.0). MidCap Energy (-19.9) is the biggest decliner so far in 2019, followed by these underperformers: SmallCap Energy (-13.0), SmallCap Communication Services (4.6), MidCap Consumer Staples (6.2), and LargeCap Health Care (6.5).

**S&P 500 Sectors and Industries Performance** ([link](#)): Four of the 11 S&P 500 sectors rose last week, and the same four outperformed the S&P 500’s 0.5% decline (versus seven rising and five outperforming the S&P 500’s 1.0% gain the week before). Utilities was the best-performing sector with a gain of 2.2%, ahead of Real Estate (2.1%), Health Care (1.0), and Energy (1.0). Last week’s underperformers: Consumer Discretionary (-2.2), Industrials (-1.5), Financials (-1.0), Communication Services (-1.0), Materials (-0.9), Information Technology (-0.8), and Consumer Staples (-0.6). All 11 sectors are up so far in 2019, compared to just two sectors rising during 2018, when the S&P 500 fell 6.3%. These six sectors have outperformed the S&P 500’s 19.4% rise ytd: Information Technology (29.6), Real Estate (26.2), Communication Services (23.0), Consumer Discretionary (21.3), Industrials (21.1), and Utilities (20.7). The ytd laggards: Health Care (6.5), Energy (6.6), Materials (15.6), Financials (17.9), and Consumer Staples (18.6).
Commodities Performance (link): Last week, the S&P GSCI index rose 3.4% for its biggest gain in 13 weeks as 15 of the 24 commodities moved higher. That compares to a 0.2% decline a week earlier when 17 commodities rose. The index had nearly climbed out of a correction during mid-April, recovering to a drop of just 10.0% shy of its high in early October 2018, after being down as much as 26.9% from that high on 12/24/18. It moved further out of a bear market in the latest week, improving to 16.9% below its 10/3/18 high. Unleaded Gasoline was the strongest performer last week, rising 7.3%, ahead of GasOil (6.8), Brent Crude (6.7), Crude Oil (6.0), and Cocoa (5.8). Coffee was the biggest decliner, with a drop of 4.2%, followed by Natural Gas (-3.7), Zinc (-3.2), and Copper (-3.0). The S&P GSCI commodities index is up 11.5% ytd following a decline of 15.4% in 2018. The top-performing commodities so far in 2019: Nickel (64.8), Crude Oil (27.9), Unleaded Gasoline (26.5), GasOil (19.9), and Gold (18.2). The biggest laggards in 2019: Kansas Wheat (-16.6), Cotton (-16.2), Live Cattle (-15.1), and Natural Gas (-13.1).

S&P 500 Technical Indicators (link): The S&P 500 price index fell 0.5% last week, and weakened relative to its short-term 50-day moving average (50-dma) and its long-term 200-day moving average (200-dma). The index’s 50-dma relative to its 200-dma fell for just the sixth time in 31 weeks and is down from a 17-month high of 5.4% in mid-August, but formed a Golden Cross for a 26th week after 16 weeks in a Death Cross formation. The index had been in a Golden Cross for 137 weeks through late November, and its previous Death Cross lasted for 17 weeks through April 2016 (when its 50-dma bottomed at a then-four-year low of 4.5% below its 200-dma in March 2016). The Golden Cross reading fell to an 11-week low of 4.2% from 4.6% a week earlier and compares to -5.2% in early February, which had matched the lowest reading since November 2011. It’s still down from a 55-month high of 7.2% in February 2018. The S&P 500’s 50-dma dropped for the first time in three weeks as the price index fell to 1.4% above its 50-dma from a seven-week high of 2.0% above its 50-dma a week earlier. It had peaked recently at mid-July at a 19-week high of 4.3% above. That was up from a 22-week low of 4.2% below its falling 50-dma at the end of May, but down from 6.6% above during mid-February, which was its highest since October 2011. The 200-dma rose for a 15th week, and at a faster rate too. It had been rising for 16 weeks through mid-May after falling from October to February in the first downtrend since May 2016 (when it had been slowly declining for nine months). The index traded above its 200-dma for a 16th week, but dropped to 5.6% above its rising 200-dma from a seven-week high of 6.7% above its rising 200-dma a week earlier. That compares to a 17-month high of 8.8% above its 200-dma at the end of July and 14.5% below on 12/24, which was the lowest since April 2009; the index remains well below the seven-year high of 13.5% above its rising 200-dma during January 2018.

S&P 500 Sectors Technical Indicators (link): Ten of the 11 S&P 500 sectors traded above their 50-dmas last week, down from all 11 above a week earlier. Consumer Discretionary moved back below in the latest week, where it has mostly been since the beginning of August. The longer-term picture—i.e., relative to 200-dmas—was unchanged w/w, with ten sectors trading above currently. That’s up from just six at the end of August, which was the lowest count since early June. The sole laggard, Energy, was below its 200-dma for a tenth week after being above—just for a week—for the first time since early October. Ten sectors are in the Golden Cross club (with 50-dmas higher than 200-dmas), unchanged from a week earlier and compared to just two in January and all 11 in January 2018. Again, Energy is the sole laggard, not having been in a Golden Cross for 44 straight weeks. Just three sectors (Consumer Staples, Real Estate, and Utilities) have rising 50-dmas now, down from nine a week ago. Among the laggards, Energy and Health Care have had mostly declining 50-dmas since late spring. Ten sectors have rising 200-dmas, unchanged in the latest week. Materials and Financials moved higher for a fourth week in their attempts at new uptrends for the first time since last September. Energy has had mostly falling 200-dmas since last October. That compares to just two sectors with rising 200-dmas in early January, in what was then the lowest count since all 11 sectors had falling 200-dmas two years before.
US ECONOMIC INDICATORS

Existing Home Sales (link): “As expected, buyers are finding it hard to resist the current rates,” Lawrence Yun, NAR’s chief economist said. “The desire to take advantage of these promising conditions is leading more buyers to the market.” Existing home sales—tabulated when a purchase closes—climbed to a 17-month high in August. Sales rose for the third time in four months, up 1.3% m/m and 5.4% over the period to 5.490mu (saar); ytd sales are now up a robust 9.8%. Three of the four regions posted sales gains in August, all but the West, though all four are now above year-ago levels; here’s a tally: Northeast (7.6% m/m & 1.4% y/y), Midwest (3.1 & 2.3), South (0.9 & 3.6), and the West (-3.4 & 1.8). Single-family sales increased 1.2% in August and 10.1% ytd to 5.490 mu (saar), while multi-family sales climbed 1.7% and 7.3%, respectively, over the comparable periods to 590,000 units (saar). The number of single-family homes on the market at the end of August edged down for the second month to 1.64 million—3% below year-ago levels; the months’ supply (4.0) remains near historical lows. “Sales are up, but inventory numbers remain low and are thereby pushing up home prices,” said Yun. “Homebuilders need to ramp up new housing, as the failure to increase construction will put home prices in danger of increasing at a faster pace than income.”

Regional M-PMIs (link): Both Fed districts that have reported on manufacturing activity for September so far—Philadelphia and New York—show activity slowed for the second month. The composite (to 7.0 from 10.8) index was the slowest since February, other than during June (-4.2), when it dipped into negative territory for the first time since May 2016. Philadelphia’s composite (12.0 from 16.8) index showed activity remained at a healthy, though slower, rate than during August, while New York’s (2.0 from 4.8) growth was near a standstill. New orders (14.2 from 16.3) growth remained robust, thanks to Philadelphia (24.8 from 25.8) billings, which held near August’s pace—which was the best since May 2018, while New York’s (3.5 from 6.7) grew at roughly half the pace of August. Employment (12.8 from 1.0) expanded at its second best pace this year, with Philadelphia (15.8 from 3.6) factories hiring at quadruple the pace of August, while New York (9.7 from -1.6) manufacturers began hiring again after cutting payrolls the previous three months.

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